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Andrew Miller

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THE NEW YORK PROPOSAL TO REVISE THE COMMUNITY REINVESTMENT ACT: A QUANTITATIVE STEP TOWARDS OBJECTIVITY AND EFFECTIVENESS

The Community Reinvestment Act of 1977¹ (CRA or the Act), designed to improve community development,² is a frequent subject of reform discussions.³ Under the CRA, depository institutions⁴ have an affirmative obligation to provide credit to the entire community they serve,⁵ including low- and moderate-income neighborhoods.⁶ The CRA requires that federal supervisory agencies⁷ examine and rate the commit-

1. Pub. L. No. 95-128, tit. VII, 91 Stat. 1147 (codified as amended at 12 U.S.C. §§ 2901-2907 (1988 & Supp. IV 1992)).

2. See *infra* notes 22-25 and accompanying text (discussing the purposes behind the CRA's enactment).

3. See, e.g., Allen J. Fishbein, *The Community Reinvestment Act After Fifteen Years: It Works, but Strengthened Federal Enforcement is Needed*, 20 FORDHAM URB. L.J. 293, 308-10 (1993) (supporting the CRA and calling for more effective enforcement of the Act); *Clinton Unveils Plans for Community Development Institutions, CRA Reform*, 61 Banking Rep. (BNA) 79 (July 19, 1993) [hereinafter *Clinton CRA Reform*] (outlining President Clinton's proposal to reform the CRA); see *infra* notes 10-21 and accompanying text (discussing criticisms of the CRA and responses to such criticisms).

4. For purposes of this Comment, "depository institutions" refers to "regulated financial institutions" subject to the CRA, such as commercial banks and thrifts, also known as savings and loan associations. 12 U.S.C. § 2902(2) (Supp. IV 1992).

5. *Id.* § 2901(a) (1988). The CRA states: "The Congress finds that . . . (3) regulated financial institutions have continuing [sic] and affirmative obligation to help meet the credit needs of the local communities in which they are chartered." *Id.*

6. *Id.* § 2903(a)(1) (Supp. IV 1992) (requiring a depository institution to assess and meet the credit needs of "its entire community, including low- and moderate-income neighborhoods").

7. Board of Governors the Federal Reserve System (FRB), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS), all have authority to conduct CRA examinations. *Id.* § 2902(1) (1988 & Supp. IV 1992).

Through its charter, the types of deposits it holds, and membership in the Federal Reserve System, depository institutions are subject to supervision by one or more supervisory agencies. CARTER H. GOLEMBE & DAVID S. HOLLAND, *FEDERAL REGULATION OF BANKING*, 1986-87, at 204 (1986). The FRB has authority to examine all bank holding companies and state-chartered banks that are members of the Federal Reserve System. *Id.* Further, the FRB will evaluate applications of state, nonmember banks involving mergers, acquisitions, and new branch openings. *Id.* at 154-55. The OCC has supervisory responsibility over commercial banks with national charters. *Id.* at 204. The FDIC examines state-

ment each depository institution has made to its local community.⁸ A depository institution's CRA performance is then taken into account by the federal supervisory agencies when evaluating deposit facility applications.⁹

Calls for reform in the administration of the CRA have been voiced from both advocates of the Act and those calling for the abolition of the CRA.¹⁰ Community based organizations (CBOs) and community advocates support the CRA because it effectively brings credit and banking services to under-served areas.¹¹ The CRA allows CBOs to protest depository institution applications on the basis of the institution's CRA performance.¹² A pattern of "regulation from below"¹³ has developed

chartered commercial banks that are not members of the Federal Reserve System, but that pay FDIC insurance premiums. *Id.* Finally, the OTS, which performs the supervisory functions formerly carried out by the Federal Home Loan Bank Board, generally supervises all savings & loan institutions. See Griffith L. Garwood & Dolores S. Smith, *The Community Reinvestment Act: Evolution and Current Issues*, 79 FED. RESERVE BULL. 251, 252 (1993) (discussing the role of the OTS and other federal agencies in supervising banking institutions under the CRA).

Under the dual banking regulatory system in the United States, depository institutions have an option to have a state charter subject to the supervisory authority of the state, or have a national charter subject to regulation by the OCC. See JOSEPH F. SINKEY, JR., *COMMERCIAL BANK FINANCIAL MANAGEMENT* 31 (3d ed. 1989). Many states, including New York, have their own versions of the CRA. A New York State-chartered commercial bank will be subject to the CRA law of New York State. N.Y. BANKING LAW § 28-b(1) (McKinney 1990).

8. 12 U.S.C. § 2903(a)(1) (subjecting depository institutions to CRA review and ratings).

9. *Id.* § 2903(a)(2). The CRA requires that the depository institution's CRA record be taken into account in the approval of an institution's "application for a deposit facility," which includes, *inter alia*, applications for opening new branches and acquiring or merging with other depository institutions. *Id.* § 2902(3) (1988); see also Jonathan R. Macey & Geoffrey P. Miller, *The Community Reinvestment Act: An Economic Analysis*, 79 VA. L. REV. 291, 300 (1993) (discussing CRA evaluation under depository institution expansion applications).

10. See *infra* notes 47-120 and accompanying text.

11. See Fishbein, *supra* note 3, at 294 (discussing the effectiveness of the CRA, and stating that "[i]n places where local community groups have made active use of the law, the CRA has proven to be a remarkably effective tool in opening access to credit for those who have felt previously shunned by the banking system").

12. See Garwood & Smith, *supra* note 7, at 255-56 (discussing the CRA's empowerment of community interest groups); see also Richard Marsico, *A Guide to Enforcing the Community Reinvestment Act*, 20 FORDHAM URB. L.J. 165, 171 (1993) (discussing the increased lending to low- and moderate-income neighborhoods as a result of CBO protests under the CRA); Peter D. Schellie, *Current Development with the Community Reinvestment Act*, 42 BUS. LAW. 943, 946 (1993) (discussing increasing CBO use of the CRA protest).

13. Fishbein, *supra* note 3, at 294 (defining "regulation from below" as localized enforcement of the CRA through protests of deposit facility expansion applications); Schel-

enabling CBOs to be the primary enforcement vehicle of the CRA.¹⁴ However, CBOs contend that the administration of the CRA is ineffective because of poor federal supervisory agency enforcement.¹⁵ The banking industry and CRA critics agree that the Act is administered poorly, but their criticism is directed toward repealing the Act itself, claiming that it misallocates credit¹⁶ and places an undue burden on the banking industry.¹⁷

In response to criticism of the CRA, the Clinton Administration has proposed regulations revising the application of the CRA to make the Act more effective, while attempting to reduce compliance costs for depository institutions.¹⁸ On the state level, the New York State Banking Department (NYSBD) has issued a proposal to reform¹⁹ its version of the federal CRA statute.²⁰ New York's proposal addresses the criticisms of

lie, *supra* note 12, at 946 (stating that CBO protests have increased in number and effectiveness).

14. Fishbein, *supra* note 3, at 294, 297 (stating that regulation from below through community protests has proven to be "a remarkably effective tool in opening access to credit for those who have felt previously shunned by the banking system").

15. *See id.* at 296-97 (asserting that federal supervisory authorities have been lax in enforcing the CRA); *see also* Robert C. Art, *Social Responsibility in Bank Credit Decisions: The Community Reinvestment Act One Decade Later*, 18 PAC. L.J. 1071, 1121-34 (1987) (discussing the FRB's reluctance to refuse depository institutions' deposit facility expansion applications based on poor CRA performance).

16. Macey & Miller, *supra* note 9, at 320 (asserting that CRA loans require depository institutions to provide credit that they would otherwise avoid, thereby reducing the economic stability of the industry). *But see* Kenneth H. Thomas, *Arguments Against CRA Don't Stand Up to Scrutiny*, AM. BANKER, Nov. 5, 1993, at 20 (stating that although the CRA is criticized as mandating specific credit allocation, the law merely requires credit to be provided equally to every area within a depository institution's community).

17. Macey & Miller, *supra* note 9, at 312-24 (asserting that the CRA unfairly burdens depository institutions, while at the same time favoring some depository institutions over others); *see infra* notes 81-84 and accompanying text (discussing criticism that the CRA misallocates credit).

18. Community Reinvestment Act Regulations, 58 Fed. Reg. 67,466 (1993) (to be codified at 12 CFR pt. 25) (proposed Dec. 21, 1993) (Office of the Comptroller of the Currency); Community Reinvestment Act, 58 Fed. Reg. 67,486 (1993) (to be codified at 12 CFR pt. 228) (proposed Dec. 21, 1993) (Board of Governors of the Federal Reserve); Community Reinvestment Act Regulations, 58 Fed. Reg. 67,493 (1993) (to be codified at 12 CFR pt. 345) (proposed Dec. 21, 1993) (Board of Directors, FDIC); Community Reinvestment Act, 58 Fed. Reg. 67,501 (1993) (to be codified at 12 CFR pt. 563e) (proposed Dec. 21, 1993) (Office of Thrift Supervision).

19. N.Y. BANKING DEP'T, IMPLEMENTATION OF SECTION 28-B OF THE BANKING LAW (COMMUNITY REINVESTMENT ACT) (1993) [hereinafter PROPOSED N.Y. REGS.] (to be codified at N.Y. COMP. CODES R. & REGS. tit. 3, §§ 76.1-.8) (proposed Nov. 3, 1993) (summarized at N.Y. St. Reg., Nov. 3, 1993, at 10).

20. N.Y. BANKING LAW § 28-b (McKinney 1990). Many states have followed the CRA in imposing affirmative obligations on state-chartered banks to lend to low- and moderate-income neighborhoods. *See infra* note 127 (listing states with community reinvestment statutes).

the federal CRA, outlines effective enforcement reforms, and seeks to protect depository institutions that are in full compliance with the CRA from CBO protests.²¹

This Comment first discusses the enactment, provisions, and enforcement of the CRA in its present form. This Comment then reviews the major criticisms of the CRA cited by community advocates in support of the Act as well as those of the banking industry and others, who call for abolition of the Act. Next, this Comment details New York's proposal to revise its CRA regulation, and outlines the Clinton proposal to revise the federal CRA. This Comment asserts that the CRA is necessary to promote development in low- and moderate-income neighborhoods, and concludes that the New York proposal to improve the administration of the CRA should be followed in revising the federal CRA.

I. ENACTMENT AND IMPLEMENTATION OF THE CRA

Congress enacted the CRA in 1977 in an effort to prevent depository institutions from "redlining,"²² that is, denying mortgage credit to particular communities despite the existence of property values sufficient to support the provision of credit in that community.²³ As enacted, the CRA imposed an affirmative obligation on depository institutions to provide credit to "low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution[s]" lending practices.²⁴ A commercial bank or savings and loan is not required to make loans deemed to be unsafe by the depository institution; rather, it is effectively prohibited from denying banking services to individuals and businesses on the basis of their location.²⁵ As enacted in 1977, the CRA's review process focused on the denial of credit to borrowers in economically chal-

21. See *infra* notes 127-203 and accompanying text (discussing the specific elements of the New York proposal).

22. Senator William Proxmire, the chief proponent of the CRA's enactment, claimed that the Act "is intended to eliminate the practice of redlining by lending institutions." 123 CONG. REC. 17,602, 17,604 (1977) (statement of Sen. Proxmire).

23. For additional definitions of redlining, see Fishbein, *supra* note 3, at 293; Macey & Miller, *supra* note 9, at 298; Orin L. McCluskey, *The Community Reinvestment Act: Is it Doing the Job?*, 100 BANKING L.J. 33, 33-35 (1983); Jonathan P. Tomes, *The "Community" in the Community Reinvestment Act: A Term in Search of a Definition*, 10 ANN. REV. BANKING L. 225, 226 (1991).

24. 12 U.S.C. § 2903(a)(1) (Supp. IV 1992).

25. See Marsico, *supra* note 12, at 174 (stating that the rating process imposed by the CRA focuses on a depository institution's lending process to insure consistent lending throughout the depository institution's community).

lenged neighborhoods,²⁶ but was not designed to prohibit discrimination against minority groups.²⁷

A. Review and Rating of Depository Institutions under the CRA

Under the CRA, federal agencies charged with supervising depository institutions are required to examine and evaluate depository institutions' policies for lending to low- and moderate-income neighborhoods.²⁸ The four federal supervisory agencies charged with this responsibility adopted identical evaluation regulations.²⁹ Examiners determine a depository institution's CRA commitment by examining five broad categories: (1) the depository institution's ascertainment of its community credit needs, (2) the marketing and types of credit offered and extended by the depository institution, (3) the geographic distribution of the depository institution's offices and the record of openings and closings of its offices, (4) the extent to which the depository institution has engaged in discrimination and other illegal credit practices of the depository institution, and (5) community development activities of the depository institution.³⁰ Specifically, examiners will review twelve individual factors demonstrating a depository institution's commitment to community development, each factor falling under one of the five categories.³¹

Based on the agency's examination, the depository institution receives a CRA rating of either "[o]utstanding," "[s]atisfactory," "[n]eeds to improve," or "[s]ubstantial noncompliance."³² The findings and conclusions of the CRA examination, including the CRA rating, are made available to the public.³³ A depository institution must define the "community"

26. See *infra* notes 79-82 and accompanying text (discussing the legislative history of the CRA).

27. See Macey & Miller, *supra* note 9, at 298 (stating that "there is no indication that Congress perceived the proposed legislation as a means of directly prohibiting discrimination in lending"). But see Art, *supra* note 15, at 1077 (stating that "[d]iscrimination against racial and ethnic minorities is the aspect of redlining that is most offensive to public policy and that has received the earliest and most thorough legislative attention").

28. 12 U.S.C. § 2903(a)(1).

29. See 12 C.F.R. pt. 25 (1993) (OCC CRA regulations); *id.* pt. 228 (FRB CRA regulations); *id.* § 345 (FDIC CRA regulations); *id.* pt. 563e (OTS CRA regulations); see also *supra* note 7 (explaining the purview of the federal supervisory agencies).

30. Uniform Interagency Community Reinvestment Act Final Guidelines for Disclosure of Written Evaluations and Revised Assessment Rating System, 55 Fed. Reg. 18,163 (May 1, 1990) [hereinafter CRA Guidelines].

31. See 12 C.F.R. § 25.7 (OCC CRA assessment factors); *id.* § 228.7 (FRB CRA assessment factors); *id.* § 345.7 (FDIC CRA assessment factors); *id.* § 563e.7 (OTS CRA assessment factors).

32. 12 U.S.C. § 2906(b)(2) (listing the CRA ratings).

33. *Id.* § 2906(b). Originally, the CRA provided only that an institution's CRA rating, based on a scale of one to five, would be made available to the public. See Nancy R.

that it is serving in order to meet its affirmative obligation to assist in community development.³⁴ CRA commitment can be demonstrated through the provision of credit and other banking services beyond mortgage lending within a community, despite the CRA's original design to prevent the denial of mortgage loans to low- and moderate-income communities.³⁵ For instance, depository institutions can receive credit toward satisfying their CRA obligations by organizing meetings with community groups, purchasing mortgage-backed securities that consist of pools of mortgages made to low- and moderate-income neighborhoods, investing in public purpose corporations, or establishing letters or lines of credit to community based organizations, private developers, and nonprofit development corporations.³⁶ This diverse list of acceptable CRA activity is consistent with safe and sound banking practices because depository institutions are not forced to allocate credit to low- and moderate-income neighborhoods in any one segment of the retail credit market, such as the mortgage market.³⁷ Furthermore, depository institutions not specifically

Wilsker, *The Community Reinvestment Act of 1977: The Saga Continues . . .*, 46 BUS. LAW. 1083, 1085-86 (1991) (discussing change in rating system as a result of 1989 amendments to the CRA). Congress amended the CRA, effective in 1990, to grant public access to additional CRA information, such as the actual amount of CRA activity conducted by reviewed depository institutions. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, tit. XII, § 1212(b), 103 Stat. 527 (codified as amended at 12 U.S.C. § 2906(b)). Further, the ratings of institutions shifted from the numerical rating to descriptions of the institution's performance that the public can easily recognize. 12 U.S.C. § 2906(b)(2).

34. See 12 C.F.R. § 25.3 (OCC community delineation requirements); *id.* § 228.3 (FRB community delineation requirements); *id.* § 345.3 (FDIC community delineation requirements); *id.* § 563e.3 (OTS community delineation requirements). The meaning of "community" under the CRA is vague. See Macey & Miller, *supra* note 9, at 300. A broad definition of community may require a depository institution to provide credit in an unfamiliar area, whereas a narrowly defined community invites CBOs from outside the defined community to challenge the institution's defined community as too narrow. See Tomes, *supra* note 23, at 240-41 (discussing the importance of a depository institution properly defining its community).

35. Community Reinvestment Act Interagency Questions and Answers, 58 Fed. Reg. 9176, 9179-80 (Feb. 19, 1993) [hereinafter CRA Q&A].

36. *Id.*

37. Supervisory agencies require that regulated institutions make CRA loans that are commensurate with safe and sound lending practices. Marsico, *supra* note 12, at 198-99 (discussing FRB's requirements that CRA loans are safe and sound). While supervisory agencies give "substantial leeway in developing specific policies and programs to meet their CRA responsibilities," they do provide specific recommendations for successful CRA programs. Statement of the Federal Financial Supervisory Agencies Regarding the Community Reinvestment Act, 54 Fed. Reg. 13,742, 13,745 (Apr. 5, 1989) [hereinafter CRA Statement].

engaged in retail or mortgage lending have more options to fulfill their CRA obligation.³⁸

B. Enforcement of the CRA

The CRA's enforcement mechanisms focus exclusively on the deposit facility application and approval process that depository institutions must abide by for most forms of institutional expansion.³⁹ The CRA was not "intended to prevent racially discriminatory lending policies"⁴⁰ and the Act provides no private right of action against depository institutions.⁴¹ In recent years, CBOs have increased their efforts in protesting applications of depository institutions on the grounds that the depository institutions have failed to meet their CRA obligations.⁴² With the increased public disclosure required by the 1989 amendments to the CRA, CBOs have been able to secure more information from the examination process, including the depository institution's CRA rating.⁴³ As a result of these protests, critics of the CRA contend that deposit facility applications by depository institutions are at the mercy of well-organized CBOs, in that a CBO may protest an application regardless of the depository institution's CRA rating.⁴⁴

38. See *infra* notes 251-52 and accompanying text (discussing increased options in CRA credit for all depository institutions, including specialty banks).

39. 12 U.S.C. § 2903(a)(2) (Supp. IV 1992) (mandating that the CRA rating of a depository institution be taken into account when approving an application for a deposit facility). Upon submission of an application to open a new branch, merge with, or acquire another depository institution, the appropriate supervisory agency may deny or conditionally accept the application on CRA grounds. Garwood & Smith, *supra* note 7, at 258-59 (discussing the application process as an enforcement mechanism for the CRA); Macey & Miller, *supra* note 9, at 300 (same); Schellie, *supra* note 12, at 945 (describing the role of the CRA compliance rating in the deposit facility application process). If the application is conditionally approved, the depository institution normally "must devise a plan to meet its CRA responsibilities and submit the plan to the appropriate regulatory agency." *Id.*

40. *Harambee Uhuru Sch. v. Kemp*, No. C2-90-949, 1992 U.S. Dist. LEXIS 15125, at *14 (S.D. Ohio Sept. 30, 1992); see also *Hicks v. Resolution Trust Corp.*, 970 F.2d 378, 382 (7th Cir. 1992) (stating that "the CRA was not enacted to govern or restrict the power and actions of private individuals").

41. See *Harambee*, 1992 U.S. Dist. LEXIS 15125, at *15-*16. In *Harambee*, an inner-city pre-school was denied a cause of action under the CRA against a bank that had allegedly denied a loan to the school on racial grounds. *Id.* at *11.

42. Schellie, *supra* note 12, at 946 (citing an increase in CBO protests of depository institutions' expansion applications). But see Garwood & Smith, *supra* note 7, at 259 (stating that only between one and two percent of expansion applications filed with the FRB are subject to CBO protest).

43. See Macey & Miller, *supra* note 9, at 300-01 (discussing the increased information available to CBOs as a result of the 1989 amendments to the CRA).

44. See Tomes, *supra* note 23, at 236-37 (citing criticism of CBO's power to delay expansion applications). Three options are available to a depository institution faced with a CBO protest: a preprotest settlement with the CBO, a postprotest settlement with the

II. CRITICISMS OF THE CRA

Advocates of the CRA support the Act's basic premise that the redlining of low- and moderate-income neighborhoods is illegal,⁴⁵ but criticize what they see as insufficient administration of the CRA by supervisory agencies.⁴⁶ Critics of the CRA generally agree that the administration of the CRA is ineffectual,⁴⁷ but rather than calling for its strengthening, they advocate repeal of the Act.⁴⁸ CRA criticism is therefore focused in two broad categories: criticism based on the premise that the CRA itself should be abolished and criticism of the administration of the Act.⁴⁹

A. Criticisms of the Act Itself

1. The CRA Unfairly Burdens Depository Institutions

A basic criticism of the CRA is its imposition of an affirmative obligation on depository institutions to market their products and provide services in particular communities, while other industries do not have such an obligation.⁵⁰ The following justifications and refutations are advanced regarding the validity of subjecting the banking industry to this type of CRA regulation.⁵¹

a. Banking: A Localized and Uncompetitive Industry

A traditional justification for subjecting depository institutions to strict regulation, such as the CRA, is that banks and thrifts have traditionally

CBO, or an agreement with the appropriate supervisory agency to increase the CRA activity of the depository institution. See Schellie, *supra* note 12, at 946-50.

45. See Art, *supra* note 15, at 1138-39 (stating that the CRA empowers CBOs and raises awareness of the importance of community development).

46. Fishbein, *supra* note 3, at 296-97 (citing inadequate enforcement of the CRA).

47. Lawrence J. White, *The Community Reinvestment Act: Good Intentions Headed in the Wrong Direction*, 20 FORDHAM URB. L.J. 281, 283 (1993) (stating that the CRA is "redundant" because depository institutions adequately serve their neighborhoods and would do so without the CRA).

48. Macey & Miller, *supra* note 9, at 347-48 (calling for repeal of the Act because it is unnecessary and harmful to the banking industry); White, *supra* note 47, at 282 (stating that "[t]he CRA approach is fundamentally flawed").

49. For a discussion of criticisms of the CRA see Thomas, *supra* note 16, at 20-21.

50. Critics present the argument as follows:

We would never insist that corn grown in Iowa farm country be returned to Iowa farms. The corn is shipped from the farms, where it is in surplus, to other areas where there is a deficit. It is not clear why credit should be different. Like corn or any other commodity, credit is allocated through a price system that directs the good to the user who values it the most.

Macey & Miller, *supra* note 9, at 308.

51. White, *supra* note 47, at 287-90 (listing society's "largely false images and impressions" of banks that are used to justify the imposition of an affirmative obligation on depository institutions to provide credit to local communities).

enjoyed a great deal of localized financial power over communities in which they operate,⁵² with ostensibly little outside competition.⁵³ CRA critics assert, however, that competition in the banking industry has increased between depository institutions and other institutions subject to the CRA as well as from financial services institutions not subject to CRA review, thus removing this justification for additional regulation.⁵⁴ For example, wholesale operations of foreign banks are not subject to the CRA.⁵⁵ Further, mutual funds, mortgage banks, pension funds, insurance companies, consumer finance firms, investment banking firms, credit unions, and other financial institutions, such as AT&T, Sears, General Electric, General Motors, and Ford, are not subject to the CRA.⁵⁶ This disparity, critics argue, imposes a discriminatory tax on banks and thrifts.⁵⁷ Although few dispute the assertion that depository institutions may be unfairly burdened, supporters of the CRA propose extending the Act to wholesale operations of foreign banks operating in the United States and to other domestic financial institutions, such as mutual funds.⁵⁸

Furthermore, CRA critics assert that banking is no longer a localized industry because increased communication⁵⁹ and the decrease of inter-

52. See *id.* at 287-88 (stating that "banks have historically wielded a great deal of economic power").

53. *Id.* at 288 (stating that while "[e]arly in the Nineteenth Century commercial banks were virtually the only source of finance," today's banks control less than 25% of credit; nonetheless, "memories linger").

54. See Macey & Miller, *supra* note 9, at 305 (stating that the banking market in the U.S. has become "far less localized in scope"); see also White, *supra* note 47, at 285-86. Two-thirds of the credit supplied to the public flows from financial institutions that are not subject to the CRA. *Id.* at 286. White goes on to state that "[i]f equity investments as a substitute for debt were included in the totals, . . . the combined banks' and thrifts' shares would be well below a quarter" of the credit provided to the public. *Id.*

55. James R. Kraus, *Membership in CRA-Style Programs A Developing Trend for Foreign Banks*, AM. BANKER, Oct. 5, 1993, at 8 (discussing foreign bank participation in CRA-type lending activity even though foreign banks are not subject to the CRA).

56. White, *supra* note 47, at 285-86 (discussing the competition faced by today's depository institutions); see also Macey & Miller, *supra* note 9, at 312 (citing various financial institutions, "including pension funds, life insurance companies, consumer finance firms, mortgage banks, credit unions, and many other firms," that compete with depository institutions, yet are not subject to the CRA).

57. Macey & Miller, *supra* note 9, at 312 (stating that "[t]he CRA . . . imposes a special, discriminatory tax on banks and savings associations, which are thereby weakened relative to other financial institutions").

58. See *Senate Banking Chairman Riegle gets Support for Regulatory Consolidation*, 61 Banking Rep. (BNA) 420, 421 (Sept. 20, 1993) (discussing calls to extend CRA coverage to other financial services institutions, such as mutual funds).

59. See Macey & Miller, *supra* note 9, at 306 (discussing improved information processing and communication as a factor in expanding banking markets).

state banking restrictions⁶⁰ have enabled depository institutions to expand their local banking market to national and international levels.⁶¹ With expanded markets, a depository institution's "community" loses its relevance.⁶² In addition, requirements to provide credit to all neighborhoods within that expanded community hinder depository institutions.⁶³ CRA critics conclude that private institutions should not have an affirmative responsibility to provide credit to all neighborhoods, rather the CBOs or the government should ensure equal credit for all communities.⁶⁴ In response, advocates of the CRA assert that despite unfair burdens placed on depository institutions, the most efficient way to provide credit to low- and moderate-income neighborhoods is through experienced bankers already present in the community.⁶⁵

b. Individual Deposits Must Be Protected

CRA advocates assert that the Act's strict regulation of depository institutions is justified because those institutions' deposits often comprise the savings of individuals and therefore must be protected.⁶⁶ CRA critics counter that banking deposits are mere commodities, therefore the loans bankers make funded by these deposits should not be subject to strict regulation.⁶⁷ However, CRA advocates stress that depository institutions are inextricably linked to their customers and to the communities in which they receive deposits, make loans, and provide other banking serv-

60. *Id.* at 305-06 (discussing the increased competition as a result of a decrease in interstate banking restrictions).

61. *See id.* at 305-07 (discussing the nationalization and internationalization of banking markets).

62. *See* Fishbein, *supra* note 3, at 310 (stating that geographic expansion of banks may increase the burden upon banks to define their communities and provide documentation of loans to those communities); *see supra* note 34 and accompanying text (discussing the importance of a depository institution to properly define its community for CRA purposes).

63. *See* Macey & Miller, *supra* note 9, at 305 (criticizing the CRA's focus on local communities).

64. *See id.* at 344-47 (discussing alternatives to the CRA that place the onus of providing credit to depressed neighborhoods on CBOs or government programs).

65. Peter P. Swire, *Safe Harbors and a Proposal to Improve the Community Reinvestment Act*, 79 VA. L. REV. 349, 367 (1993) (stating that depository institutions are in a better position than the government to provide credit to local communities because depository institutions "are already in the business of making loans, are guided by the profit motive, and are less likely to allow political pressures to determine their investments").

66. *See* White, *supra* note 47, at 289 (stating that "banks have always been perceived as special because of the special nature of their liabilities: *deposits*").

67. *See supra* note 50 (noting CRA critics' assertion that as the farmer has no restrictions to whom he sells his wheat, the banker should be able to package deposits into loans and sell to whomever she wishes).

ices.⁶⁸ Further, individual depositors often entrust their life savings with a depository institution within the community.⁶⁹ The depositors, who provide necessary funding for depository institutions, expect and deserve more than simple interest rate return on their deposits.⁷⁰ CRA advocates assert that all depositors, regardless of economic background, should have adequate and effective banking services available to assist in economic development of the individual family and the community in general.⁷¹

c. *Banks Benefit from Government Protection*

Continued regulation of the banking industry is justified, CRA advocates assert, in light of the history of regulation in the industry and the recent government bailout of the thrift industry.⁷² Further, banking industry regulation is appropriate, it is argued, because depository institutions receive unique benefits from the Federal Reserve System.⁷³ In order to prevent financial panics, depository institutions are uniquely protected from failure by a government "safety net" that includes deposit insurance and access to emergency funding from the discount window at the Federal Reserve.⁷⁴ Additional support for continued regulation comes from the theory that depository institutions protect a large portion of society's assets, provide liquidity to the financial system, and "transmit" monetary policy.⁷⁵ CRA critics respond to these claims by asserting that depository institutions must pay for deposit insurance, and although depository institutions benefit from the government safety net, other fi-

68. See Fishbein, *supra* note 3, at 310 (discussing the need for banks to focus on community services as the banking industry markets expand).

69. SINKEY, *supra* note 7, at 25 (discussing deposits as liabilities on a depository institution's balance sheet).

70. See Vincent Di Lorenzo, *Public Confidence and the Banking System: The Policy Basis for Continued Separation of Commercial and Investment Banking*, 35 AM. U. L. REV. 647, 651 (1986) (discussing expectations of depositors at commercial banks).

71. See Arthur E. Wilmarth, Jr., *Too Big to Fail, Too Few to Serve? The Potential Risks of Nationwide Banks*, 77 IOWA L. REV. 957, 1048-49 (1992) (discussing the CRA's "moral imperative" to call upon depository institutions to provide credit to the community in which they are chartered).

72. See White, *supra* note 47, at 289-90 (stating that the justification for regulation of the banking industry results from taxpayers perception that they were forced to "bailout and rescue" depository institutions).

73. McCluskey, *supra* note 23, at 37 & n.19 (stating that existing depository institutions enjoy reduced competition because banking charters are granted on a limited basis).

74. Helen A. Garten, *What Price Bank Failure?*, 50 OHIO ST. L.J. 1159, 1171 (1989) (discussing the government safety net provided to financial institutions); see William M. Isaac & Melanie L. Fein, *Facing the Future—Life Without Glass-Steagall*, 37 CATH. U. L. REV. 281, 301 (1988) (discussing the government protection offered to depository institutions).

75. See Isaac & Fein, *supra* note 74, at 301.

financial services institutions enjoy similar benefits but are not subject to the CRA.⁷⁶

2. *CRA Regulations and Amendments: The Legislative History of the Original Act*

Regulations promulgated by the federal supervisory agencies under the CRA take into account evidence of a depository institution's discrimination against particular potential borrowers.⁷⁷ CRA critics argue that these regulations are inappropriate, claiming that the legislative history of the Act illustrates that it was not intended to prevent discrimination directly, but only to prohibit redlining.⁷⁸ However, supporters of the CRA assert that the presence of lending discrimination strongly suggests a depository institution's lack of continual community commitment—which the CRA was designed to address—as low- and moderate-income neighborhoods are largely comprised of members of racial and ethnic minority groups.⁷⁹ Furthermore, members of minority groups are more likely to be denied credit within those communities.⁸⁰

76. Macey & Miller, *supra* note 9, at 311-12 (discussing the competitive effects of increased FDIC premiums).

77. See CRA Guidelines, *supra* note 30, at 18,174. Under the uniform guidelines, an examiner is instructed to evaluate a depository institution's compliance with several antidiscrimination laws, including: The Equal Credit Opportunity Act, Pub. L. No. 93-495, tit. VII, 88 Stat. 1521 (codified as amended at 15 U.S.C. § 1691 (1988)); The Fair Housing Act of 1968, Pub. L. No. 90-284, tit. VIII, 82 Stat 81 (codified as amended at 42 U.S.C. §§ 1341-3619 (1988)); and the Home Mortgage Disclosure Act of 1975, Pub. L. No. 94-200, tit. III, 89 Stat. 1125 (codified as amended at 12 U.S.C. §§ 2801-2809 (1988)). See CRA Guidelines, *supra* note 30, at 18,174. Examiners must also evaluate the institution's compliance with any agency regulations pertaining to nondiscriminatory treatment of credit applicants. *Id.* For example, ECOA prohibits depository institutions from denying credit on the basis of race and other prohibited bases, while the FHA prohibits racial and ethnic discrimination in mortgages. See Art, *supra* note 15, at 1079. The HMDA generally requires depository institutions to "record the race, sex, and income of applicants for all mortgages and home improvement loans, including loans denied and withdrawn" and report those records to the federal government. Garwood & Smith, *supra* note 7, at 255.

78. Macey & Miller, *supra* note 9, at 298-99. Professor Art agrees that the CRA does not attack discrimination, but says the Act's "purpose and effects are consistent with the statutes prohibiting discrimination, because allegations of failure to meet the credit needs of a community are frequently correlated with allegations of racial discrimination." Art, *supra* note 15, at 1079.

79. Marsico, *supra* note 12, at 174 (stating that "arbitrary impediments to lending such as discrimination" are vehicles for detecting CRA noncompliance).

80. A study by the Federal Reserve Bank of Boston found that minorities applying for a mortgage with "the same economic and property characteristics as white applicants would experience a denial rate of 17 percent rather than the actual white denial rate of 11 percent." ALICIA H. MUNNELL, ET AL., MORTGAGE LENDING IN BOSTON: INTERPRETING HMDA DATA 2 (Federal Reserve Bank of Boston Working Paper No. 92-7, 1992).

3. *The CRA Misallocates Credit*

Although the CRA provides that all CRA-qualified loans should be made commensurate with safe and sound banking practices, critics assert that the CRA misallocates credit by funneling credit and banking services into high-risk communities where the return on capital or investment is low and risk is high.⁸¹ CRA critics contend that if CRA loans were otherwise profitable and safe, then depository institutions would make them regardless of CRA requirements.⁸²

In response, supporters of the CRA assert that the Act was specifically written to avoid credit allocation and gives depository institutions the ability to choose the types of loans, investments and activities that they may provide to low- and moderate-income communities.⁸³ Further, supporters of the CRA state that despite stricter credit review and lower profit margins, CRA loans remain profitable.⁸⁴ Supporters also state that although the CRA focuses on mortgage lending, other avenues of CRA credit are available to add to the diversity of a depository institution's CRA portfolio, thus reducing the risk of exposure to any single segment

81. The problem of misallocation is articulated as follows:

The CRA impairs the safety and soundness of an already over-strained banking industry: it promotes the concentration of assets in geographically nondiversified locations, encourages banks to make unprofitable and risky investments and product-line decisions, and penalizes banks that seek to reduce costs by consolidating services or closing or relocating branches. The statute, moreover, imposes a significant tax on bank mergers and deters transactions that would otherwise improve the efficiency and solvency of the nation's banking system.

Macey & Miller, *supra* note 9, at 295.

82. *Id.* at 319-20 (asserting that while "there are some profitable loans to be made in low-income and moderate-income communities [, this] does not mean that greatly increasing lending in such communities is going to be a profitable activity").

83. See Thomas, *supra* note 16, at 20 (citing criticism that the CRA means credit allocation).

84. Marilyn F. Friedman, *Profits Await in CRA Home Loans*, AM. BANKER, Jan. 9, 1992, at 4 (stating that CRA loans can be safe and profitable despite higher maintenance costs); Thomas, *supra* note 16, at 20 (stating that "[n]o bank ever failed because of the Community Reinvestment Act"). In remarks before Congress, New York State Superintendent of Banks Derrick D. Cephas stated: "Banks in New York have been able to make CRA loans without unacceptable risk. Indeed, as a general matter, 'CRA loans' have not subjected banks in New York to any material repayment or credit risk, although administrative costs have generally been higher for 'CRA loans.'" *Effective Implementation of the Community Reinvestment Act: Hearing Before the Subcomm. on General Oversight, Investigations, and Resolution of Failed Financial Institutions of the House Comm. on Banking and Urban Affairs*, 103d Cong., 1st Sess. 26, 38 (1993) (statement of Derrick D. Cephas, Superintendent of Banks, New York State Banking Department) [hereinafter Cephas Testimony].

of the low- and moderate-income banking market.⁸⁵ For instance, a depository institution will receive credit for investing in mortgage-backed securities packaged from affordable housing mortgages located within the depository institution's defined community.⁸⁶ Depository institutions may also receive CRA credit by pooling financing assets in other institutions that, in turn, provide financing for affordable housing developments.⁸⁷

B. Criticisms of the Administration of the CRA

1. Significant Compliance Burdens

Depository institutions complain that the compliance costs of the Act are excessive due to the extensive documentation requirements for their CRA activities.⁸⁸ Currently, supervisory agencies reward depository institutions for the quality of their procedures to earmark funds that are intended to receive CRA credit.⁸⁹ This process-oriented review forces depository institutions to expend a large portion of their CRA resources on documentation of their CRA activity, rather than concentrating CRA resources on actual lending to enhance community development.⁹⁰ This emphasis on process has led depository institutions to call for more objec-

85. See Mary Colby, *Banks in the 'Hood: Turning the Tap in America's Forgotten Neighborhoods*, BANK MGMT., July 1993, at 26, 27 (discussing the diverse range of CRA-related activities of commercial banks committed to CRA lending).

86. CRA Q&A, *supra* note 35, at 9179 (stating that CRA credit will be received); see *supra* note 36 and accompanying text (discussing various methods in which a depository institution may gain CRA credit).

87. See Friedman, *supra* note 84, at 4 (describing the Community Preservation Corporation in New York City which receives funds from a consortium of banks to lend to affordable housing projects); Kraus, *supra* note 55, at 8 (describing contributions to the Global Resources for Affordable Neighborhood Development program, funded through a consortium of banks to provide credit for development of affordable housing).

88. See Barbara A. Rehm, *ABA: Cost of Compliance Equals 59% of Bank Profits*, AM. BANKER, June 18, 1992, at 1, 12 (discussing banker opinion that compliance with the CRA is the most expensive component of federal bank regulation). The estimated cost of compliance with federal regulations, including the CRA, was equal to 59% of the commercial banking industry's total profits, or \$10.7 billion in 1991, according to the American Bankers Association. *Id.* at 1. Costs included salaries and benefits for employees hired to comply with regulations, as well as costs associated with outside consultants, lawyers, and employee training. *Id.* at 12.

89. See Linda Corman, *Study Finds Documentation Biggest Factor in CRA Rating*, AM. BANKER, June 3, 1991, at 7 (reporting the importance of good documentation in receiving a high CRA rating); Francis X. Grady, *CRA Success Starts with a Plan*, AM. BANKER, July 30, 1991, at 4 (discussing the need to establish a CRA plan of documentation in order to receive a high CRA rating).

90. Corman, *supra* note 89, at 7; Grady, *supra* note 89, at 4.

tive CRA review in order to decrease their compliance costs.⁹¹ In response, CBOs, also critical of the process-oriented review, call for CRA review focusing on the positive effects a depository institution makes on community development.⁹²

2. *Unfair Burdens on Wholesale and Specialty Banks*

CRA critics argue that wholesale and specialty depository institutions are unfairly burdened when compared to other depository institutions providing traditional retail banking services.⁹³ These unique banking entities make conscious business decisions not to compete in the market for retail services in their communities, yet they remain subject to the CRA.⁹⁴ A depository institution that makes other business decisions, such as closing a branch, may also risk losing CRA credit.⁹⁵ CRA advocates, however, assert instead of limiting the purview of the CRA to depository institutions, it should be extended to all financial institutions.⁹⁶

3. *Subjective and Inadequate Enforcement of the CRA*

Like CRA critics, the Act's advocates also criticize its enforcement, contending that supervisory agency CRA review is too subjective and that the enforcement mechanisms of the Act are too lenient.⁹⁷ To avoid government-mandated credit allocation,⁹⁸ the CRA imposed a vague affirmative obligation on depository institutions to provide credit to low- and moderate-income neighborhoods.⁹⁹ Supervisory agencies steadfastly

91. Lawrence B. Lindsey, 79 FED. RESERVE BULL. 1127, 1129 (Dec. 1993) (discussing President Clinton's calls to reform the CRA "that replace paperwork and uncertainty with greater performance, clarity, and objectivity").

92. See *infra* notes 101-05 and accompanying text (discussing calls to amend the CRA review process).

93. Macey & Miller, *supra* note 9, at 313-18 (discussing the disproportionately negative effects of the CRA on nonretail oriented depository institutions).

94. *Id.* at 317 (discussing the obligations imposed on specialized banks by the CRA despite those banks' decisions not to make retail loans).

95. *Id.* at 315 n.82 (stating that if a bank withdraws from a depressed community, "the implication is rather clear that [a depository] institution will lose CRA points if it closes a branch and fails to provide the subsidy").

96. See *supra* note 58 and accompanying text (discussing calls to extend the CRA to all financial institutions).

97. New York Banking Superintendent Cephas has said that "the [CRA] rating system is far too subjective. There is a paucity of standards by which to measure CRA compliance, and far too little objectivity in the rating system." Cephas Testimony, *supra* note 84, at 27.

98. Credit allocation is described as a government-mandated extension of credit into particular communities, that infringes upon the credit decisions of private depository institutions. See Art, *supra* note 15, at 1083 (discussing credit allocation and proposals for its adoption advanced in the legislative history of the CRA).

99. 12 U.S.C. § 2901 (1988).

avoid credit allocation through CRA regulation by emphasizing in its examination the review of the process an institution utilizes to provide credit to all communities, rather than dictating the particular loans or investments that must be made.¹⁰⁰

Process-oriented examination has led community activists and government officials to complain that the CRA has not resulted in real changes in the provision of credit to needy neighborhoods.¹⁰¹ In 1989, continued criticism of the CRA's poor performance led Congress to amend the Act in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 by providing for more disclosure about a depository institution's CRA performance.¹⁰² Further, process-oriented examination leads depository institutions to emphasize documentation of loans and other CRA activity, rather than to focus on making loans that improve community development.¹⁰³ Thus, a disproportionate number of large depository institutions receive the highest CRA ratings because of enhanced documentation capabilities provided by economies of scale.¹⁰⁴ This subjective evaluation process has led both state and federal officials to call for a more objective CRA evaluation process that focuses on whether a depository institution actually improves community development in its defined community.¹⁰⁵

4. *Burden of CRA Protests by Community Groups*

One of the most severe criticisms of the CRA is that the public is allowed to protest an application of a depository institution due to the institution's failure to meet its CRA obligation.¹⁰⁶ Critics assert that these protests, regardless of the institution's CRA rating,¹⁰⁷ delay applica-

100. See Marsico, *supra* note 12, at 174 (stating that while CBOs often focus on the outcome of their actions, CRA evaluations by federal supervisory agencies are "process-oriented"); McCluskey, *supra* note 23, at 49 (noting that the emphasis in CRA enforcement is on encouraging dialogue between CBOs and depository institutions rather than results-oriented review).

101. See Fishbein, *supra* note 3, at 296-97 (discussing ineffectual CRA evaluations).

102. *Id.* (discussing criticisms in Congress of CRA enforcement in 1988); see *supra* note 33 (discussing the increased disclosure requirements in the FIRREA Amendments).

103. Macey & Miller, *supra* note 9, at 330-33. A study conducted by the Community Reinvestment Institute found that the highest CRA ratings were received by depository institutions that could best document their performance, not the institutions with the most loans to low- or moderate-income neighborhoods. Corman, *supra* note 89, at 7.

104. Corman, *supra* note 89, at 7.

105. See *infra* notes 147-72 and accompanying text (discussing New York's proposal to objectify the CRA review process).

106. Tomes, *supra* note 23, at 236-37 (citing critics of the CBO protest process).

107. See, e.g., Linda Corman, *CRA Challenges Jolt Top-Rated Institutions*, AM. BANKER, Mar. 28, 1991, at 1 (discussing the protest of a Manufacturers Hanover Trust Company deposit facility application despite a top CRA rating).

tions¹⁰⁸ and exact concessions from the depository institution to CBOs sufficiently organized to submit a protest.¹⁰⁹

CRA supporters praise CBO protests as the most effective tool for accurate enforcement of depository institutions' CRA obligations.¹¹⁰ In spite of their impact, community advocates consistently complain that regulators exaggerate the CRA ratings of depository institutions.¹¹¹ Furthermore, the utility of CRA ratings is somewhat diminished by supervisory agencies being reluctant to deny applications on the basis of CRA infractions.¹¹²

Nonetheless, lack of efficient CRA enforcement by supervisory agencies themselves results in "regulation from below" that enables CBOs to be the true CRA enforcement mechanism.¹¹³ Protests enable a CBO to enter into negotiations with a depository institution in order to increase

108. See, e.g., Tomes, *supra* note 23, at 236 (citing criticism that the CRA protest process unnecessarily hampers deposit facility applications). However, others assert that concern for delay is exaggerated. Garwood & Smith, *supra* note 7, at 260 ("In general . . . the worry about delay is exaggerated. Significant delay as the result of a CRA protest or a rating issue is the exception, not, as commonly assumed, the rule."); see also Fishbein, *supra* note 3, at 305 (citing statistics showing that CBO protests do not delay a depository institution's application).

109. A depository institution dealing with a CRA challenge confronts the dilemma of "placat[ing] the protestant by funding its pet project rather than by adopting a more even-handed approach that would promote community development generally." Macey & Miller, *supra* note 9, at 335.

110. See Fishbein, *supra* note 3, at 294 (citing statistics estimating that CRA protests have led to over \$30 billion in loan commitments from depository institutions to low- and moderate-income neighborhoods).

111. *Id.* at 296. Between 1985 and 1988 only 2.4% of 26,000 CRA examinations of depository institutions by federal regulatory agencies resulted in poor CRA ratings of three or below based on a scale of one to five. *Discrimination in Home Mortgage Lending: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs*, 101st Cong., 1st Sess. 7 (1989). On August 16, 1993, the OCC results of 475 CRA examinations of national commercial banks conducted between February 1 and July 31, 1993, disclosed that 421, or 88.6%, of the banks received a CRA rating of satisfactory or outstanding. Kevin T. Kane, *Banking on Community Development and CRA Reform: The Clinton Plan*, 61 *Banking Rep.* (BNA) 350, 351 (Aug. 30, 1993).

112. Fishbein, *supra* note 3, at 298 (discussing CBO protests and the evaluation of CRA ratings by federal supervisory agencies); see also Art, *supra* note 15, at 1110 (stating that "a noncomplying depository institutions faces no significant danger of denial of an application to branch out or merge"). Between 1977 and 1987, it is estimated that only eight out of approximately 40,000 deposit facility applications were denied by federal supervisory authorities. Fishbein, *supra* note 3, at 298 (citing statistics from the Center for Community Change). After the 1989 Amendments requiring public disclosure of CRA ratings, the number of ratings in the lowest grades—"needs to improve" or "substantial noncompliance"—have increased to approximately ten percent. See Macey & Miller, *supra* note 9, at 301 (citing *A "Better than Satisfactory" Grade?*, AM. BANKER, June 15, 1992, at 10).

113. See Fishbein, *supra* note 3, at 294. As a result of CBO protests, federal supervisory agencies focus more attention than usual on the CRA performance of the depository institution that has submitted a deposit facility application. Art, *supra* note 15, at 1095.

lending into a particular community.¹¹⁴ Depository institutions often respond quickly and generously to community protests.¹¹⁵ For example, in anticipation of a protest from the Arizona chapter of the Association of Community Organizations for Reform Now (ACORN) of an application by Chase Manhattan Corporation (Chase) to acquire Continental Bank of Arizona, Chase negotiated an agreement to provide over \$2 million in mortgage loans to low- and moderate-income neighborhoods and \$100,000 in grants to various CBOs.¹¹⁶

Regulators encourage depository institutions and CBOs to negotiate settlements, rather than have them deny an application.¹¹⁷ In a joint statement recommending how depository institutions can develop an effective CRA program, the federal supervisory agencies expressed their desire that depository institutions communicate with local communities continually regarding credit needs¹¹⁸ while requesting CBOs to comment on an institution's CRA performance.¹¹⁹ CBOs are cognizant of the importance of protests, and organize to bring them against depository institutions effectively.¹²⁰

III. PROPOSED CHANGES TO THE CRA

The ongoing bailout of the thrift industry has led to a reluctance among lawmakers to deregulate the banking industry. There is also a societal disposition that the provision of credit from private entities is vital for community development.¹²¹ Further, evidence of discrimination against

114. A protest is not most effective in blocking an application by a depository institution. Fishbein, *supra* note 3, at 298 (stating that "the effectiveness of the CRA challenge process usually rests with the ability of the community group leaders to use the law to negotiate an agreement under which applicants make specific commitments to improve their community reinvestment records"); see also Marsico, *supra* note 12, at 171-72 (discussing the use of CBO protests to enforce the CRA).

115. Depository institutions have three options in dealing with a CBO protest: settle with the CBO threatening to protest prior to submission of the application; settle the protest after the CBO has protested the application; or provide guarantees to the supervisory agency to improve the depository institution's CRA practices. See Schellie, *supra* note 12, at 946-50.

116. *Id.* at 947; Robert E. Mannion & Michael A. Faber, *Hibernia Sets Example in Community Reinvestment Act Protest*, AM. BANKER, Sept. 5, 1986, at 4, 6 (discussing Hibernia Corporation's response to a CRA protest).

117. CRA Statement, *supra* note 37, at 13,745.

118. *Id.*

119. *Id.*

120. See generally Marsico, *supra* note 12 (providing instructions for a CBO to bring a CRA protest).

121. See Art, *supra* note 15, at 1075-76 (discussing the importance of private lending in community development); White, *supra* note 47, at 289-90 (discussing the bailout of the thrift industry as a justification for regulation).

minorities through the denial of banking services has increased awareness that the banking industry must be encouraged to provide credit to minority residents, who tend to live in low- and moderate-income neighborhoods.¹²² Despite calls by critics to repeal the CRA, these factors have encouraged¹²³ both the New York State Banking Department¹²⁴ and the federal supervisory agencies¹²⁵ to propose revisions in the regulation of the CRA in order to improve the effectiveness of the Act and better promote community development.¹²⁶

A. Reform of the New York CRA

Several states have enacted their own version of the CRA applicable to depository institutions chartered within the state.¹²⁷ In 1978, New York State enacted CRA requirements that mirror the federal CRA.¹²⁸ The New York CRA subjects New York State-chartered banks and thrifts¹²⁹ to CRA evaluation by the New York State Banking Department (NYSBD).¹³⁰ The general categories that the NYSBD takes into consideration when examining a depository institution,¹³¹ along with the twelve assessment factors in determining a CRA rating, are identical to the fed-

122. In October 1992, the Federal Reserve Bank of Boston (Boston Fed) released an in-depth analysis of mortgage loans to black, Hispanic and white residents of the Boston area which found that whites enjoyed a mortgage denial rate six percent lower than that of comparably situated minority applicants. See Boston Fed Study, *supra* note 80, at 1-2. Further, the Justice Department's investigation of an Atlanta thrift for discriminatory lending practices shortly after it received a favorable CRA rating raised the suspicion of several Congressmen. See *House Banking Chair Asks GAO for Armor in Regulatory Relief Fight with Industry*, 60 Banking Rep. (BNA) 369 (Mar. 22, 1993) (citing letter from House Banking Committee chairman Henry Gonzalez to Comptroller General Charles Bowsher).

123. See *supra* notes 50-87 and accompanying text (detailing the criticisms of the basic premise of the CRA).

124. PROPOSED N.Y. REGS., *supra* note 19.

125. Introduction of Proposed Federal Regulations, 58 Fed. Reg. 67,466 (1993).

126. See *id.* (reiterating that the CRA was enacted to insure that low- and moderate-income neighborhoods receive equal banking services).

127. See CONN. GEN. STAT. ANN. §§ 36-52a to 52d (West 1987 & Supp. 1993) (requiring examiners to assign CRA ratings to state chartered depository institutions); MINN. STAT. ANN. §§ 47.80-.84 (West 1988 & Supp. 1994) (directing bank examiners to rate regulated depository institutions' record of meeting the needs of the entire community); N.Y. BANKING LAW § 28-b (McKinney 1990) (requiring bank examiners to provide CRA ratings for each depository institution); WASH. REV. CODE ANN. §§ 30.60.010-.901 (West 1986) (requiring the rating of depository institution's commitment to the entire community).

128. 1978 N.Y. LAWS 788 (codified as amended at N.Y. BANKING LAW § 28-b).

129. N.Y. BANKING LAW § 28-b(4).

130. *Id.*

131. N.Y. COMP. CODES R. & REGS. tit. 3, § 76.4(b) (1990).

eral regulatory criteria.¹³² The CRA rating determined by the NYSBD¹³³ must be taken into account when a depository institution submits an application to the New York Superintendent of Banks.¹³⁴ Finally, as provided in the federal CRA, CBO protests of a depository institution's application under the New York CRA are considered in approving a deposit facility application.¹³⁵

The NYSBD is the first financial institution supervisory authority to issue a proposal addressing criticisms of the CRA and attempting to improve the Act's effectiveness.¹³⁶ The NYSBD would revise its regulations in order to make the review process more objective¹³⁷ by shifting from a process-oriented review mechanism to a results-oriented mechanism, focusing on the actual positive effects of CRA lending.¹³⁸ The NYSBD proposal provides incentives to depository institutions to comply with the CRA on a more consistent basis,¹³⁹ while attempting to increase the effectiveness of the NYSBD in enforcing the CRA.¹⁴⁰

132. N.Y. BANKING LAW § 28-b(3)(a); N.Y. COMP. CODES R. & REGS. tit. 3, § 76; see *supra* note 31 and accompanying text (discussing assessment factors utilized in federal CRA review).

133. N.Y. BANKING LAW § 28-b(2). The rating is based on a scale of 1 to 4 with a "1" rating considered "outstanding" and a "4" rating considered "substantial noncompliance." N.Y. COMP. CODES R. & REGS. tit. 3, § 76.4(a). The depository institution's rating is made available to the public. *Id.* § 76.4(b).

134. N.Y. BANKING LAW § 28-b(3)(a).

135. *Id.* § 28-b(3)(b).

136. On October 7, 1993, the NYSBD released the final version of its proposed changes with a comment deadline of December 15, 1993. Letter from Derrick D. Cephas, Superintendent of Banks, the State of New York Banking Department, to Chief Executive Officers of Depository Institutions and Executive Directors of Community Groups 1 (Oct. 7, 1993) (on file with the *Catholic University Law Review*) [hereinafter Cephas Letter]. In the proposal Superintendent Cephas stated "CRA enforcement and compliance in its current form is a disorderly process with few concrete guidelines and procedures to assist the banks in complying or to assist regulators in measuring that compliance." *Id.* New York revised the CRA regulations rather than amending the CRA statute. See N.Y. BANKING LAW § 28-b(5).

137. Cephas Letter, *supra* note 136, at 1.

138. The NYSBD believes: "[T]he current CRA system encourages banks to focus on process, procedure and documentation at the expense of a more substantive, investment-oriented approach." *Id.* at 2.

139. Cephas states "the current system places far too much emphasis on enforcing the CRA solely in the context of the regulatory approval process." Cephas Testimony, *supra* note 84, at 27-28.

140. *Id.* at 2-3. Superintendent Cephas remarked that "the structure of the current system inevitably produces conflict between [depository institutions] and community groups." *Id.* at 2. The NYSBD states that regulation from below provides a disincentive for depository institutions to demonstrate a consistent CRA commitment because the institutions anticipate that they will have to make CRA concessions and commitments upon filing an application. *Id.* at 3. Further, there is a disincentive for CBOs to put constant

In developing its proposal to revise the CRA, the NYSBD consulted with the banking industry, community advocates, CBOs, academics, and public officials.¹⁴¹ Public input in the process of New York's CRA revision has led to constructive criticism to improve the plan and facilitate discussion among government, depository institutions, and CBOs.¹⁴²

This plan has received criticism, however, from both the banking industry and community advocates.¹⁴³ It generally is agreed that the revised CRA will require larger amounts of CRA funds from depository institutions¹⁴⁴ and will be more complicated to enforce.¹⁴⁵ New York's changes, proposed to address these criticisms, fall roughly into four categories, providing: (1) a quantitative or objective analysis of a depository institution's community commitment coupled with a qualitative analysis of CRA activity; (2) a safe harbor for depository institutions that receive an "outstanding" CRA rating for a period of three consecutive years, which precludes the Superintendent from taking into account the depository institution's CRA commitment when considering an application; (3) an expansive, nonexhaustive list of depository institution activity that automatically will receive CRA credit; and (4) a preinvestment opinion mechanism through which a depository institution may request a determination as to whether a particular investment will receive CRA credit before the investment is made.¹⁴⁶

1. *Quantitative and Qualitative CRA Review*

The heart of the New York proposal is an attempt to increase objectivity in the CRA examination process and decrease the regulatory compliance burden on depository institutions, while still allowing for unique characteristics of an individual depository institution's lending activity to

pressure on depository institutions to provide credit because the CBO can exact more money from the institution at the time of an application. *Id.*

141. *Id.* at 11. On September 9, 1992, the NYSBD released a list of twelve questions asking for public comment on various aspects of the proposed changes in regulation. NEW YORK STATE BANKING DEPT., PROPOSED COMPREHENSIVE POLICY STATEMENT RELATING TO THE NEW YORK STATE COMMUNITY REINVESTMENT ACT: REQUEST FOR PUBLIC COMMENT (1992). Over 70 comments were received and the NYSBD heard testimony from 44 witnesses. Cephas Letter, *supra* note 136, at 1.

142. See Cephas Testimony, *supra* note 84, at 36-37 (discussing the involvement of banks, community advocates, and public officials in revising CRA regulations).

143. See Saul Hansell, *New York Tightens Law on Community Lending*, N.Y. TIMES, Oct. 8, 1993, at D1, D11 (discussing the proposal to revise New York CRA regulation).

144. *Id.*

145. Cephas Letter, *supra* note 136, at 6. Superintendent Cephas states that the CRA proposal "is complex—indeed, more so than we had hoped—but only to the extent necessary to accomplish the task of balancing the several conflicting needs." *Id.*

146. *Id.* at 3-8 (outlining specific provisions of the proposal).

be considered in determining an institution's CRA rating.¹⁴⁷ Under the proposal, the NYSBD will conduct a quantitative review that compares the amount of CRA qualified loans, investments, and other activities a depository institution conducts as compared to the institution's total deposits.¹⁴⁸ Retail depository institutions¹⁴⁹ will receive an outstanding preliminary CRA rating¹⁵⁰ if the ratio of the institution's total FDIC insured deposits¹⁵¹ to CRA qualified loans, investments, or other activities exceeds thirty percent.¹⁵² If the ratio is thirty percent or less, the preliminary CRA rating will be lower.¹⁵³

The NYSBD tempers its potentially strict quantitative analysis with a qualitative review addressing the criticism that certain depository institutions would be disadvantaged in that they are either small, have limited CRA opportunities, or are in poor financial condition, and are thus unfairly burdened by a qualitative comparison to other retail depository institutions.¹⁵⁴ The qualitative review allows an institution's final CRA rating to be raised or lowered, based on an analysis of the institution's CRA commitment using factors that are currently employed in assessing a depository institution's CRA rating.¹⁵⁵ Despite the availability of this

147. *Id.* at 1-2 (proposing the need to make CRA review more objective).

148. *Id.* at 4.

149. *See infra* notes 163-65 and accompanying text (discussing different treatment for community banks and wholesale depository institutions).

150. New York's CRA rating system is based on a 1-4 scale, but reflects roughly the same ratings as the federal supervisory agencies. *See supra* note 33 and accompanying text (discussing the federal CRA rating system).

151. Aggregate FDIC insured deposits are used because they best reflect a depository institution's local retail deposits and are the principal source of funding that distinguishes depository institutions from other financial services institutions that are not subject to the CRA. Cephas Letter, *supra* note 136, at 4 n.1. Though this method may be most effective in determining the proper ratio of CRA activities to deposits, the method is over inclusive. Commercial banks engaged in wholesale banking retain FDIC insurance and pay premiums on these deposits. Therefore, using deposits based on FDIC assessment of premiums includes deposits that are not necessarily retail deposits. However, quantitative CRA standards for wholesale depository institutions are lower than that of retail depository institutions making the CRA Deposit Base less important.

152. *See infra* notes 157-65 and accompanying text (discussing qualifying CRA loans, investments, and activities and their various weights for CRA credit).

153. For retail depository institutions, a ratio of 20% to 30% will receive a "satisfactory" preliminary rating; 15% to 19.9% will receive a "needs to improve" preliminary rating; a ratio of less than 15% will receive a "substantial non-compliance" preliminary rating. PROPOSED N.Y. REGS., *supra* note 19, § 76.6(c)(ii).

154. The NYSBD states that any CRA review process is inherently subjective and a certain qualitative review is required to prevent poor CRA ratings for depository institutions that are demonstrating sufficient CRA commitments. Cephas Letter, *supra* note 136, at 4.

155. *Id.* For a discussion of the twelve factors that are currently considered by regulatory authorities, see *supra* notes 30-31 and accompanying text.

qualitative analysis, the NYSBD asserts that it will place "a far greater emphasis on the quantitative" analysis in order to make the overall examination process as objective and predictable as possible.¹⁵⁶

Under the revised CRA, the NYSBD will weight different types of CRA loans, investments, and activities that a depository institution makes in order to provide incentives to make loans that are particularly beneficial to low- and moderate-income neighborhoods.¹⁵⁷ For instance, a direct loan to a consumer within a depository institution's community will receive CRA credit equal to the amount of the loan.¹⁵⁸ However, a mortgage loan to finance a one to four family home loan in a low- or moderate-income neighborhood will receive CRA credit of twice the amount of the mortgage, while letters of credit supporting community development lending programs within the depository institution's community will receive CRA credit of three times the amount of the letter of credit.¹⁵⁹ Therefore, a depository institution may achieve an outstanding preliminary CRA rating while the ratio of its total CRA-credited loans, investments, and other activities to total FDIC insured deposits does not exceed thirty percent.¹⁶⁰

In addition to tempering the impact of the quantitative review on certain institutions, the weighting of various CRA activities also addresses the criticism that CRA credited activity harms the safety and soundness

156. Cephas Letter, *supra* note 136, at 6.

157. PROPOSED N.Y. REGS., *supra* note 19, § 76.6(c)(iii).

158. *Id.*

159. *Id.* The NYSBD lists seven broad categories of CRA loans, investments or activities that have a CRA adjustment factor. *Id.* These categories are consumer loans, loans to consortia, community development loans, housing loans, small business and farm loans, letters of credit, and miscellaneous. *Id.* In all, the NYSBD has proposed adjustment factors for 26 types of CRA loans, investments, or activities that will receive CRA credit. *Id.* Though this is not an exhaustive list, the NYSBD has not explained how it will weight activities that have not yet been weighted, but that will still receive CRA credit. *Id.*

160. For example, if a retail depository institution has \$100 million of deposits on which it pays FDIC deposit insurance premiums, the depository institution must make \$30 million in CRA loans, investments, or other activity in order to receive an "outstanding" rating. However, with the weighted adjustment factor, the depository institution may achieve the \$30 million in CRA credit in the following way: (1) \$10 million in direct loans to consumers; (2) \$250 thousand in loans to low- and moderate-income residents within the depository institution's defined community; (3) \$7.5 million investment in a consortium that benefits low- and moderate-income persons within the depository institution's community; and (4) \$680 thousand grant to a community development organization.

In this example, the depository institution only has to risk \$250 thousand of credit in low- and moderate-income areas. Further, the depository institution could write a check for roughly \$8.2 million in order to fulfill 65% of its CRA obligation, thus foregoing compliance costs of loan approval. Thus, under the weighted adjustment factor, the actual CRA commitment of the depository institution is only \$18.68 million for \$30 million worth of CRA credit and an "outstanding" preliminary CRA rating.

of the banking industry.¹⁶¹ By weighting certain loans, investments, and other activities, the NYSBD encourages depository institutions to diversify CRA portfolios and decrease the risk of excessive exposure to any one type of CRA credited activity.¹⁶² The criticism that the CRA unfairly burdens wholesale and specialty depository institutions is also addressed through the weighting of certain investments.¹⁶³ Wholesale depository institutions will receive enhanced CRA credit for investments in or the provision of credit to specialized institutions that provide community development financing.¹⁶⁴ Similarly, grants to CBOs will receive CRA credit in an amount seven times the actual amount of the grant.¹⁶⁵

The NYSBD distinguishes between wholesale and retail depository institutions' preliminary CRA rating standards in order to address the criticism that wholesale depository institutions do not have the same opportunities to "participate in CRA-related activities" as retail depository institutions.¹⁶⁶ With this adjusted standard, wholesale depository institutions are not disproportionately burdened by the CRA and are free therefore to pursue their desired type of banking business.¹⁶⁷ "Commu-

161. See *supra* note 81 and accompanying text (discussing criticism that the CRA adversely affects the safety and soundness of the banking industry).

162. See *supra* note 37-38 and accompanying text (discussing the importance of diversity in CRA portfolios).

163. See *supra* notes 93-95 and accompanying text (discussing criticism that the CRA unfairly burdens wholesale and specialty depository institutions).

164. See Krause, *supra* note 55, at 8 (stating that foreign banks in New York contribute money to a CRA-style program that provides credit towards affordable housing projects and low-income families). This type of activity will receive CRA credit only to a certain point. PROPOSED N.Y. REGS., *supra* note 19, § 76.6(c)(iii) n.3. In an effort to prevent depository institutions from simply writing a check to fulfill their CRA obligation, thereby avoiding the affirmative obligation to provide credit to all communities, no more than 50% of the depository institution's total CRA activity may come from loans or investments to consortia. *Id.* A consortium is an institution created by a group of depository institutions in order to make CRA related loans. See Claudia Cummins, *Community Lending Pays Off, Study Finds*, AM. BANKER, Sept. 2, 1993, at 9 (discussing the importance of lending through consortia for depository institutions to gain CRA credit).

165. PROPOSED N.Y. REGS., *supra* note 19, § 76.6(c)(iii). No more than 15 percent of a retail depository institution's total CRA activity and 30 percent of a wholesale depository institution's total CRA activity will receive credit for such grants. *Id.* § 76.6(c)(iii) n.4.

166. Cephas Letter, *supra* note 136, at 5 n.2 (stating that wholesale and retail depository institutions are distinguished "in recognition of the significant differences in the business operations of these two types of banking institutions"). For purposes of determining the preliminary CRA rating in the quantitative review, wholesale depository institutions will receive higher ratings with substantially less CRA activity. PROPOSED N.Y. REGS., *supra* note 19, § 76.6(c)(ii). A wholesale depository institution will receive an outstanding preliminary rating for a ratio of greater than 8%; a substantial compliance preliminary rating for a ratio of 5% to 8%; a needs to improve rating for a ratio of 3% to 4.9%; and a substantial non-compliance rating for a ratio of less than 3%. *Id.*

167. Specialty banks, such as banks that exclusively provide trust services or private banking to individuals, are hindered by CRA requirements similar to wholesale banks. See

nity banks," defined as small, retail banks that concentrate business in a certain area,¹⁶⁸ are not subject to the quantitative analysis and will be deemed to have a satisfactory preliminary CRA rating.¹⁶⁹ Under the revised CRA, the NYSBD is satisfied that an institution meeting the definitional requirements of a community bank may be presumed to be in compliance.¹⁷⁰ However, community banks are still subject to the qualitative analysis, thus exposing them to CRA examination and the possibility of a lower rating.¹⁷¹ Although depository institutions are examined differently based on the niche in the banking market they serve, the essence of the CRA, that all depository institutions have an affirmative obligation to lend to all within a defined community, remains.¹⁷²

2. Safe Harbor for Highest-Rated Depository Institutions

The New York proposal contains a safe harbor¹⁷³ provision that precludes CRA scrutiny for applications submitted by depository institutions that have received outstanding ratings for three consecutive years.¹⁷⁴ This safe harbor will remove CBO opportunities to protest applications submitted by depository institutions qualifying for the safe harbor.¹⁷⁵ Once qualification for the safe harbor is attained, the depository institution may enjoy the safe harbor as long it maintains an outstanding CRA rating.¹⁷⁶

Significantly, the New York safe harbor proposal is denied to any depository institution that a court finds has "engaged in discriminatory

Macey & Miller, *supra* note 9, at 317 (stating that specialty banks, similar to wholesale banks, are disproportionately burdened by CRA requirements). The New York regulations do not provide an adjusted review process for these specialty banks.

168. PROPOSED N.Y. REGS., *supra* note 19, § 76.2(a).

169. Cephas Letter, *supra* note 136, at 5.

170. *Id.*

171. See Phil Zahodiakin, *N.Y. Proposes to Ease Paperwork For Banks Under \$150 Million*, AM. BANKER, Oct. 20, 1993, at 8 (stating that community bankers would rather be subject to quantitative rating than to attempt to get an outstanding rating through the qualitative review).

172. See Cephas Letter, *supra* note 136, at 5 n.2 (discussing nonretail depository institution's CRA obligations under the proposal).

173. Under the CRA, a safe harbor is described as:

a regime that includes a general standard that restricts activity, such as the CRA requirement that banks invest in their local communities. The safe harbor also includes a more specific rule that can make activity per se legal, such as the proposed safe harbor if banks invest enough in qualifying CRA investments.

Swire, *supra* note 65, at 350.

174. PROPOSED N.Y. REGS., *supra* note 19, § 76.8(b).

175. Cephas Testimony, *supra* note 84, at 34-35 (explaining the safe harbor provision contained in the New York plan to revise CRA regulations).

176. Cephas Letter, *supra* note 136, at 7. Although a depository institution attains the safe harbor, annual CRA inspections will continue. *Id.*

lending practices.”¹⁷⁷ Critics of this provision may contend that denial of the safe harbor based on lending discrimination contradicts the legislative history of the CRA.¹⁷⁸ However, an institution that engages in lending discrimination would find it difficult to sustain that it is meeting its affirmative obligation to low- and moderate-income neighborhoods.¹⁷⁹ Proof of lending discrimination will not automatically reduce the CRA rating of the depository institution; rather, it will simply give CBOs and the NYSBD an opportunity to focus on the depository institution’s CRA commitment in approving the application.¹⁸⁰

Advocates for the use of a safe harbor provision in CRA enforcement state that the safe harbor may take different shapes, ranging from a “pure form” to a form that allows depository institutions minimal relief from CRA protests.¹⁸¹ A pure form of the safe harbor would eliminate misallocation of credit problems and compliance costs because a depository institution would earn the safe harbor simply by writing a check instead of going through the process of providing credit.¹⁸² The pure form of the safe harbor may also be modified to require that depository institutions maintain an affirmative CRA obligation even while enjoying the safe harbor.¹⁸³ The safe harbor could be given to depository institutions that comply with a CRA plan preapproved by the appropriate supervisory agency and developed by the depository institution itself.¹⁸⁴

New York modifies the pure form of the safe harbor by placing a continuing affirmative obligation on all depository institutions to improve community development, even after attainment of the safe harbor through demonstrated excellence in CRA lending.¹⁸⁵ Because CRA activity must continue even for depository institutions that attain the safe harbor, New York’s proposal will not reduce compliance costs or misallo-

177. PROPOSED N.Y. REGS., *supra* note 19, § 76.8(b).

178. *See supra* notes 77-81 and accompanying text (discussing legislative history of the CRA).

179. *See* Marsico, *supra* note 12, at 174 (stating that “arbitrary impediments to lending such as discrimination are condemned by” supervisory agencies).

180. PROPOSED N.Y. REGS., *supra* note 19, § 76.8(b).

181. Swire, *supra* note 65, at 356-57 (discussing various uses of a safe harbor to protect depository institutions against CBO protests of deposit facility applications).

182. *Id.* at 356-57 (discussing the benefits of a pure safe harbor).

183. *Id.* at 356.

184. *Id.* The NYSBD suggested revising the CRA by assessing a depository institution’s CRA rating based on compliance with a CRA plan that the institution has developed for itself. Cephas Letter, *supra* note 136, at 7. The NYSBD rejected this proposal on the belief that “measuring a bank’s performance against its own plan is not a reasonable standard, unless the regulators are required to approve the adequacy of the plan in the first instance.” *Id.*

185. *See* Cephas Letter, *supra* note 136, at 7 (describing the safe harbor provision).

cation of credit problems that the pure form safe harbor would address.¹⁸⁶ However, New York effectively addresses the criticism that CBO protests hinder the application process, while providing an incentive for depository institutions to improve and maintain their CRA performance.¹⁸⁷ Further, the New York safe harbor mechanism will also assert regulation from above for depository institutions in full compliance with the Act, thus insulating depository institutions with demonstrated CRA commitment from frivolous CBO attack.¹⁸⁸

3. *List of Eligible CRA Loans, Investments, and Other Activities*

In order to increase objectivity in the CRA review process and decrease documentation costs associated with proving that a particular activity is eligible for CRA credit, the New York proposal provides an expansive list of fifteen areas of activity and investments, beyond loans, that automatically will be considered as CRA-credited activity.¹⁸⁹ The NYSBD established this list to provide diversity to depository institutions seeking to comply with the CRA,¹⁹⁰ thus reducing the unfair burden placed on wholesale banks that do not participate in retail community lending. In addition, the list of automatically credited activities will provide guidance and clarity to wholesale banks seeking to receive CRA credit in different and imaginative ways.¹⁹¹

Direct lending remains the primary method of fulfilling a depository institution's CRA obligation under the proposal.¹⁹² However, in revising the CRA, the NYSBD desired to demonstrate to depository institutions that CRA credit is available from diverse sources.¹⁹³ To address concerns

186. Swire, *supra* note 65, at 356 (stating that "[a]s the safe harbor proposal becomes more complicated . . . its likely benefits are reduced").

187. See Cephas Letter, *supra* note 136, at 2 (discussing how the proposal will encourage community groups and depository institutions to cooperate, thus providing an incentive for depository institutions to improve their CRA commitment).

188. See *supra* notes 100-20 and accompanying text (discussing the criticism that CBOs are a detriment to the deposit facility application process).

189. Cephas Letter, *supra* note 136, at 3; see *infra* note 197 (providing examples of CRA credited activity).

190. Cephas Letter, *supra* note 136, at 3 (stating that the purpose of the list was "to provide a greater range of opportunities for [depository institutions] to satisfy their CRA obligations").

191. *Id.* (stating that the list was intended to assist wholesale depository institutions).

192. PROPOSED N.Y. REGS., *supra* note 19, § 76.3(a).

193. Cephas Letter, *supra* note 136, at 3. CRA credit is automatically received for pro-bono financial advice to municipal corporations, investment in joint projects with the New York State government, origination of low- and moderate-income housing, and community development loans. PROPOSED N.Y. REGS., *supra* note 19, § 76.3(b). Further, CRA credit is explicitly available for investments in community development banks "as such term may be defined from time to time under federal law." *Id.*

that the automatic credit list is an attempt to allocate credit into certain areas,¹⁹⁴ the NYSBD list is not exhaustive; other investments or activities may receive credit on an individually approved basis.¹⁹⁵ Thus, a depository institution need not necessarily engage strictly in listed loans, investments, and activities to achieve the highest CRA rating.¹⁹⁶

4. *Preinvestment Opinion of CRA Eligibility*

Under the revised CRA, the NYSBD provides a mechanism for preapproval of CRA credit for unique loans, investments, and other activities.¹⁹⁷ This mechanism decreases compliance costs through reducing the uncertainty of receiving CRA credit and motivating depository institutions to apply innovative techniques in community development.¹⁹⁸ However, the NYSBD will opine only on whether the activity will receive CRA credit, and will not "address its appropriateness, suitability or compliance with safety and soundness standards."¹⁹⁹ Further, through the encouragement of diverse and new sources of CRA credit, the preapproval mechanism reduces safety and soundness concerns, while, at the same time, providing additional avenues of CRA credit for depository institutions not engaged in retail banking.²⁰⁰

B. *CRA Reform Proposal from the Clinton Administration*

Currently, the Clinton Administration is concerned that present CRA regulation on the federal level promotes process and paperwork over results-oriented supervision.²⁰¹ In order to address this concern, a two-fold plan has been proposed to improve community development, focusing on revising CRA regulation and providing federal funding to "community development banks" (CDBs) that provide credit for community development.²⁰² The four federal supervisory agencies charged with supervising

194. See *N.Y. State Banking Board Proposes Revised Regulation to Implement CRA Requirements*, 61 Banking Report (BNA) 590 (Oct. 18, 1993) [hereinafter *Banking Board Proposal*] (discussing the list of loans, investments, and activities that will receive CRA credit under the proposed New York regulations).

195. Cephas Letter, *supra* note 136, at 3.

196. PROPOSED N.Y. REGS., *supra* note 19, § 76.3(b).

197. *Id.* § 76.4.

198. *Id.*

199. *Id.*

200. See *supra* notes 81-87 and accompanying text (citing critics' assertions that the CRA affects the safety and soundness of the banking industry).

201. See Swire, *supra* note 65, at 357 (discussing President Clinton's motivations for revising the federal CRA regulations); *Clinton CRA Reform*, *supra* note 3, at 79-81 (discussing proposed revisions in CRA regulation initiated by President Clinton).

202. *Clinton CRA Reform*, *supra* note 3, at 79-81 (discussing proposed revisions in CRA regulation initiated by President Clinton).

depository institutions issued for public comment a proposal to revise the CRA.²⁰³

The proposed regulations respond to President Clinton's directive to make the CRA review process more objective, by focusing on the results of depository institutions' CRA programs rather than on the program implementation process.²⁰⁴ The federal proposal abandons the twelve-factor evaluation process currently used by regulators to assess CRA ratings.²⁰⁵ In its place, the federal supervisory agencies propose to review objectively the amount of loans made in retail depository institutions' service areas, and to review the amount of investments made in wholesale depository institutions' service areas, to determine the CRA rating for an individual institution.²⁰⁶

Under a proposed "lending test," a retail depository institution will be rated according to the amount of loans it makes in low- and moderate-income neighborhoods in its community as compared to its total loans.²⁰⁷ Under a proposed "investment test," wholesale and specialty depository institutions will be evaluated using the amount of CRA qualified investments the institution makes as compared to its total capital.²⁰⁸ Wholesale and specialty depository institutions are distinguished from retail depository institutions in order to address the criticism that wholesale depository institutions are disproportionately burdened by the CRA.²⁰⁹ All depository institutions will be subject to a "service test" in which the institution's final CRA rating may be raised or lowered based on the acces-

203. Community Reinvestment Act Regulations, 58 Fed. Reg. 67,479 (1993) (to be codified at 12 CFR pt. 25) (proposed Dec. 21, 1993) (Office of the Comptroller of the Currency); Community Reinvestment, 58 Fed. Reg. 67,486 (1993) (to be codified at 12 CFR pt. 228) (proposed Dec. 21, 1993) (Board of Governors of the Federal Reserve); Community Reinvestment Act Regulations, 58 Fed. Reg. 67,493 (1993) (to be codified at 12 CFR pt. 345) (proposed Dec. 21, 1993) (Board of Directors, FDIC); Community Reinvestment Act, 58 Fed. Reg. 67,501 (1993) (to be codified at 12 CFR § 563e) (proposed Dec. 21, 1993) (Office of Thrift Supervision).

204. Kane, *supra* note 111, at 350-54 (providing an analysis of President Clinton's plan).

205. See 58 Fed. Reg. 67,468 (1993) (summarizing the various proposed regulations).

206. See *id.* (discussing the various tests).

207. Community Reinvestment Act Regulations, 58 Fed. Reg. 67,466, 67,480-81 (1993) (to be codified at 12 CFR pt 25) (proposed Dec. 21, 1993) (Office of the Comptroller of the Currency).

208. *Id.* at 67,481-82 (proposed regulation for the investment test).

209. 58 Fed. Reg. 67,468 (1993) (summary of proposed regulations) (discussing different evaluation methods for different depository institutions). Further, small depository institutions would benefit from a "streamlined assessment method" that seeks to reduce compliance costs. *Id.* at 67,469 (discussing the examination methods for small depository institutions); see *supra* notes 89-92 and accompanying text (discussing criticism that wholesale and specialty banks are unfairly burdened by the CRA).

sibility of the institution's branches and other banking services to customers in low- and moderate-income communities.²¹⁰

IV. CONSTRUCTIVE REVISION OF AN EFFECTIVE ACT

A. *The CRA Is Successful*

Largely lost in the debate over revision of the CRA is the fact that large amounts of credit, investments, and activities from depository institutions are being provided to low- and moderate-income neighborhoods as a result of the CRA, effectively improving community development.²¹¹ Furthermore, despite its critics, regulation from below is effective in improving community development.²¹² Although there exist refutable criticisms that the CRA is an unfair burden on the banking industry,²¹³ that the language of the Act is inconsistent with legislative intent,²¹⁴ and that the CRA results in a misallocation of credit,²¹⁵ regulatory supervisory authorities avow the past effectiveness of the CRA and correctly focus on enhancing, rather than abolishing, the Act.²¹⁶

Despite the CRA's success, reform of the administration of CRA review is necessary in order to enhance community development and reduce compliance burdens while maintaining a safe and sound banking industry.²¹⁷ Further, regulation from below should not be removed from the CRA enforcement process except for institutions that clearly demonstrate a consistent commitment to community development through ex-

210. 58 Fed. Reg. 67,468 (1993) (discussing the service test).

211. See, e.g., Colby, *supra* note 85, at 27 (discussing successful "community reinvestment vehicles" depository institutions have employed to comply with the CRA); Garwood & Smith, *supra* note 7, at 251 (discussing the CRA's influence on improving community development); Thomas, *supra* note 16, at 20-21 (discussing how CRA-mandated lending practices can be profitable for depository institutions).

212. See Fishbein, *supra* note 3, at 298 (citing studies that show that regulation from below has encouraged depository institutions to make over \$7.5 billion in CRA commitments as a result of direct CBO negotiation as well as unilateral commitments of \$23 billion).

213. See *supra* notes 52-76 and accompanying text (citing the criticism that depository institutions should not be subject to regulation).

214. See *supra* notes 77-81 and accompanying text (discussing the legislative intent of the CRA).

215. See *supra* notes 81-88 and accompanying text (citing the criticism that the CRA misallocates credit).

216. See Proposed Federal Regulations, *supra* note 18, at 67,466-67 (discussing the need for reform of the CRA, not abolishment of the Act); Cephas Letter, *supra* note 136, at 1 (discussing drawbacks of current CRA regulation and calling for a strengthening of the regulation of the Act).

217. See 58 Fed. Reg. 67,466, 67,467 (1993) (summarizing the various proposed regulations and discussing criticisms of the CRA and the need for reform); see also Thomas, *supra* note 16, at 21 (stating that "[t]he law [CRA] is working, but it can be improved").

cellent CRA performance.²¹⁸ Reflective of these goals, the New York proposal to revise its CRA is progressive and effectively addresses the criticisms of current CRA enforcement.²¹⁹ Thus, the New York proposal should be used as a model in current efforts to reform the federal CRA regulations.²²⁰

B. *Emphasis On Quantitative Review*

The most beneficial aspect of the New York CRA reform proposal is a shift from ineffective process-oriented review to an examination of the actual benefits of a depository institution's CRA activity on community development.²²¹ In order to ensure the continued effectiveness of the CRA, it is of paramount importance that depository institution examinations rely primarily on objective, quantitative review to assess depository institutions' final CRA ratings.²²² Use of objective, rather than subjective, qualitative review criteria, most closely ensures that depository institutions fulfill their affirmative obligation to assist in the community development of low- and moderate-income neighborhoods.²²³ Moreover, objective review further improves regulation from above and eliminates the criticism that the supervisory agencies are lenient and subjective in rating depository institutions.²²⁴

The quantitative review, along with the weighting system provides certainty to depository institutions that particular loans, investments, and other CRA activity will earn defined CRA credit; institutions will know

218. See Fishbein, *supra* note 3, at 298 (discussing the effectiveness of regulation from below); see *supra* note 209 (citing statistics showing the success of CBO negotiation with depository institutions).

219. Warren Traiger, *New York's Efforts to Improve Its CRA May Create Model for Federal Reform*, AM. BANKER, Sept. 28, 1993, at 18 (stating that New York's efforts to revise its version of the CRA could be used as an example for reform of the federal CRA).

220. See *id.*

221. See *supra* notes 97-105 and accompanying text (discussing the negative effects of process-oriented CRA review methods).

222. Cephas Letter, *supra* note 136, at 6. The NYSBD states "a combination of quantitative analysis and qualitative analysis with a far greater emphasis on the quantitative, should be predictable, fair and reasonable because of the combination of rigor and flexibility." *Id.*

223. See Fishbein, *supra* note 3, at 293 (discussing the CRA's requirement that depository institutions meet the credit needs of their entire local community). Some bankers oppose the increased focus on objective criteria because they believe that many depository institutions will have to increase their CRA loans in order to meet the quantitative CRA review standards. Karen Gullo, *N.Y. Proposal Turns Up Heat on Banks to Increase Their Lending to Minorities*, AM. BANKER, Oct. 8, 1993, at 6 (discussing the increased level of low-income lending that depository institutions will have to make under the new plan).

224. See *supra* note 97 and accompanying text (discussing the criticism of subjective CRA ratings from supervisory agencies).

the quantitative CRA rating for different practices before an examination.²²⁵ The weighting of CRA activity reduces safety and soundness concerns,²²⁶ while at the same time reducing the burden on wholesale and specialty depository institutions to perform banking services they choose to avoid.²²⁷

Despite the benefits of quantitative review, qualitative review remains necessary for the few institutions with deceptive quantitative ratings.²²⁸ For these and other institutions, compliance costs associated with the revised CRA remain high²²⁹ and the existence of a qualitative review mechanism allows the final CRA rating to be reduced using the current burdensome review process.²³⁰ A safe harbor should therefore be placed in the review process that would allow depository institutions receiving an outstanding quantitative review to avoid a qualitative review.²³¹ This safe harbor provision would reduce compliance costs and provide depository institutions, including those that are not planning a deposit facility application, to improve their CRA compliance.²³²

C. Safe Harbor Through Effective and Objective Regulation

Effective and objective CRA review, along with the use of the safe harbor provision, will improve the importance and effectiveness of the CRA.²³³ The increased incentive for depository institutions to achieve the safe harbor through increased CRA commitment to the community²³⁴ will benefit CBOs more than the present method of protesting a

225. See Cephas Letter, *supra* note 136, at 6 (stating that an objective CRA examination process is preferable to the current examination process).

226. See *supra* notes 161-65 and accompanying text (discussing the reduction of risk as a result of the weighting system).

227. See *supra* notes 166-72 and accompanying text (discussing New York's proposal to treat wholesale, specialty, and retail depository institutions differently).

228. See Cephas Letter, *supra* note 136, at 4 (stating that "no reasonable system of CRA evaluation should completely eliminate the qualitative (and therefore subjective) nature of the CRA review").

229. See Zahodiakin, *supra* note 171, at 8 (citing complaints by some bankers that the proposed retention of the qualitative review will hurt final CRA ratings).

230. PROPOSED N.Y. REGS., *supra* note 19, § 76.6(c)(iv); see *supra* notes 88-92 and accompanying text (discussing the current burdensome CRA review process).

231. This protection would be considered a safe harbor. See *supra* note 181 and accompanying text (discussing the uses of a safe harbor in the CRA).

232. See Zahodiakin, *supra* note 171, at 8 (discussing community banks' preference for a depository institution's final CRA rating to be based solely on a quantitative review).

233. See Swire, *supra* note 65, at 372 (discussing how the safe harbor provision will provide increased certainty to depository institutions).

234. *Id.* If the safe harbor allows depository institutions that achieve outstanding preliminary CRA reviews to avoid qualitative review, depository institutions that are not planning to file an application still have an incentive to achieve the highest rating to reduce documentation costs.

depository institution's application to gain commitments on an aggregate level.²³⁵ Currently, there is little incentive for depository institutions to maintain consistent CRA compliance because a protest of the depository institution's application is likely to occur regardless of its rating.²³⁶ In contrast, objective and efficient regulation from above is essential if the safe harbor is to be effective in providing incentives for depository institutions to comply with the CRA.²³⁷ Under the safe harbor proposal, the most effective enforcement mechanism, the CBO protest, is removed from the enforcement process for the best rated depository institutions.²³⁸ If an institution gains the safe harbor as a result of outstanding ratings achieved through the subjective qualitative review, rather than through strict reliance on the quantitative review, the benefit of CBO input will be lost.²³⁹

The safe harbor mechanism will reduce criticisms that the CRA misallocates credit²⁴⁰ because depository institutions qualifying for the safe harbor will not be forced to appease CBOs through commitments the institution would not ordinarily make²⁴¹ in order to receive application approval.²⁴² CBOs, however, will have an opportunity to be heard on a consistent basis because, under the New York model, the responsible supervisory agency will hear comments on the depository institution's CRA commitment at each annual review.²⁴³ If this input is effectively used, CBOs will organize to ensure that depository institutions comply consistently with the CRA, rather than enforcing that commitment only when an application is submitted.²⁴⁴ Further, community input will improve

235. See *id.* at 367 (stressing that even under the present version, the benefits of the CRA to society outweigh the costs to the banking industry).

236. Cephas Testimony, *supra* note 84, at 28-29 (stating that there exists no current incentive for a depository institution to maintain consistent CRA compliance).

237. See *supra* note 187 and accompanying text (discussing the safe harbor provision as an incentive for depository institutions).

238. See Fishbein, *supra* note 3, at 304-05 (citing safe harbor critics' contention that the provision denies effective enforcement of the CRA through removal of the CBO protest).

239. CBOs contend that adoption of the safe harbor would mean "that the public would have no way to comment on proposed bank actions that would have great impact on their community." *Id.* at 304.

240. See *supra* note 186 and accompanying text (stating that modifying the pure form safe harbor does not decrease the misallocation of credit criticisms of the CRA).

241. See Schellie, *supra* note 12 *passim* (suggesting that the sole reason depository institutions deal with CBOs is to insure passage of a deposit facility application).

242. See Macey & Miller, *supra* note 9, at 335 (stating that depository institutions "are often well-advised" to settle with the CBO "rather than . . . adopting a more even-handed approach that would promote community development generally").

243. Cephas Letter, *supra* note 136, at 8.

244. Cephas Testimony, *supra* note 84, at 28-29 (stating that CBOs currently only have incentive to focus on a depository institution's CRA compliance at the time of the deposit facility application).

the NYSBD's ability to detect areas within the community in need of banking services.²⁴⁵

The safe harbor incentive for depository institutions actively to seek and improve CRA ratings, coupled with a heightened expectation of the CRA commitment of depository institutions through the quantitative review process,²⁴⁶ will result in increased and consistent interaction between depository institutions and CBOs.²⁴⁷ Further, more consistent relations between depository institutions and CBOs in negotiations that are less contentious than the protest process²⁴⁸ will facilitate lending and, ultimately, community development.²⁴⁹

D. List of CRA-Credited Activities Enhances Enforcement

An expansive list of CRA-credited activities will provide certainty to depository institutions, while reducing an institution's documentation costs. No longer will a depository institution have to defend particular loans, investments, or other activities through documentation in order to receive CRA credit from the regulator.²⁵⁰ Further, concerns over the effect of the CRA on the safety and soundness of the industry are addressed through providing credit for a diverse and expansive list of loans, investments, and other activities.²⁵¹ A depository institution need not simply concentrate on mortgage loans in lower-income neighborhoods; it may also enter into other forms of investment within the community.²⁵² To respond to criticism that the list amounts to credit allocation for favored areas of lending for the supervisory agency,²⁵³ it is important that the supervisory agency be objective and liberal in adding to the list.²⁵⁴

245. Cephas Letter, *supra* note 136, at 8 (discussing the use of CBO input in the annual CRA examination process).

246. See Gullo, *supra* note 223, at 6 (stating that the New York proposal will require that depository institutions increase CRA loans in order to maintain CRA ratings achieved under the current CRA rating process).

247. See Cephas Letter, *supra* note 136, at 2 (expressing the hope that the New York proposal will improve relations between CBOs and depository institutions).

248. See Cephas Testimony, *supra* note 84, at 28 (discussing the current polarization between CBOs and depository institutions).

249. See *id.*

250. *Id.* at 5 (stating that the list provides guidance to depository institutions).

251. *Id.*

252. PROPOSED N.Y. REGS., *supra* note 19, § 76.3(b).

253. See *Banking Board Proposal*, *supra* note 194, at 590 (discussing the list of loans, investments, and activities that will receive CRA credit).

254. See Cephas Letter, *supra* note 136, at 3 (stating that the list "is not intended to preclude banks from pursuing other CRA activities not set forth on the list").

E. Pre-Approval of CRA Credit Must Be Prompt

Prompt responses to requests for rulings on whether a particular activity not on the list will receive credit is necessary to encourage depository institutions to utilize the system.²⁵⁵ This will increase certainty in the CRA process and encourage diverse and innovative approaches to community development.²⁵⁶

V. CONCLUSION

Despite ineffective enforcement, the CRA has effectively assisted in community development in inner-city and rural areas alike. New York's proposal to revise its version of the federal Act has caused CRA advocates to assert that CBO power will be usurped,²⁵⁷ while CRA critics have asserted that supervisory authorities are dictating where depository institutions should allocate credit.²⁵⁸ However, New York's proposal to revise its CRA effectively addresses the administrative criticisms of the Act. As federal supervisory authorities reform the federal CRA, New York's proposal should be used as a model to improve the effectiveness of the federal CRA.

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255. See *supra* notes 198-201 and accompanying text (discussing the pre-approval mechanism).

256. Cephas Letter, *supra* note 136, at 3 (stating that this mechanism will encourage loans, investments, and other activities that would otherwise not be made).

257. See Fishbein, *supra* note 3, at 304-05 (stating community activists' fear that the safe harbor provision will remove an effective enforcement mechanism).

258. See *supra* notes 194-96 and accompanying text (discussing the criticism that the list of activities amounts to credit allocation).

